DEPARTMENT OF STATE REVENUE LETTER OF FINDINGS: 01-0099 Individual Income Tax For the Tax Years 1998 and 1999

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ISSUE

I. Imposition of the State's Individual Income Tax.

Authority:

U.S. Const. amend. XVI; Ind. Const. art X, § 8; IC 6-3-1-3.5 et seq.; IC 6-3-1-9; IC 6-3-1-12; IC 6-3-1-15; New York v. Graves, 300 U.S. 308 (1937); Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921); Eisner v. Macomber, 252 U.S. 189 (1920); Doyle v. Mitchell, 247 U.S. 179 (1918); Stratton's Independence v. Hobert, 231 U.S. 399 (1913); United States v. Connor, 898 F2d 942 (3rd Cir. 1990); Wilcox v. Commissioner of Internal Revenue, 848 F2d 1007 (9th Cir. 1988); Coleman v. Commissioner of Internal Revenue, 791 F2d 68 (7th Cir. 1986); United States v. Koliboski, 732 F2d 1328 (7th Cir. 1984); United States v. Romero, 640 F2d 1014 (9th Cir. 1981); Snyder v. Indiana Dept. of State Revenue, 723 N.E.2d 487 (Ind. Tax Ct. 2000); Thomas v. Indiana Dept. of State Revenue, 675 N.E.2d 362 (Ind. Tax. Ct. 1997); Richey v. Indiana Dept. of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer is of the opinion that, because he is not a corporate entity, he is not subject to the Indiana individual adjusted gross income tax.

STATEMENT OF FACTS

Taxpayer filed Indiana individual income tax returns for 1998 and 1999. On both returns, taxpayer reported federal adjusted gross income of "0." Attached to taxpayer's 1999 return was an explanation in which taxpayer stated that, under the relevant Supreme Court decisions, taxpayer did not receive taxable income during 1999. Taxpayer requested and was erroneously granted a refund of taxes withheld for the tax years 1998 and 1999. Subsequently, the Department issued a "Notice for Payment" which is the subject of the taxpayer's protest.

DISCUSSION

I. <u>Imposition of the State's Individual Income Tax.</u>

Taxpayer claims that the federal – and by implication, Indiana's – individual income tax is only applicable to corporate profits. Taxpayer argues that the Corporation Excise Tax Act of 1909, The U.S. Const. amend. XVI, and the Income Tax Act of 1913, 1916, and 1917 all impose a tax on the gain derived from capital or labor provided that the gain is realized from profits realized through the sale or conversion of capital assets.

Taxpayer has provided a number of Supreme Court cases which purportedly support taxpayer's basic contention. Taxpayer cites to Merchants' Loan Trust Company v. Smietanka, 255 U.S. 509 (1921) for the proposition that income tax can only be levied against corporate gains. In that case, the Court held that the when a provision in a will created a trust, the increase of the value of the trust resulted in taxable "income" under the provisions of the U.S. Const. amend. XVI. Id. In arriving at that decision, the Court stated that "the word [income] must be given the same meaning and content in the Income Tax Acts of Congress that was given to it in the Corporation Excise Tax Act and that what that meaning is has now become definitely settled by decisions of [the] court." Id. 519.

Taxpayer also cites to <u>Eisner v. Macomber</u>, 252 U.S. 189 (1920), in which the Court addressed the issue of whether the U.S. Const. amend. XVI permitted the government to tax a taxpayer's stock divided resulting from a corporation's accumulated profits. The Court held that the stock dividend did not involve the realization of a taxable gain but that the corporation's accumulated profits were simply capitalized or retained as surplus. <u>Id.</u> at 211. In effect, the taxpayer in <u>Eisner</u> did not realize a gain severed from and independent of the corporations' assets. <u>Id.</u> at 211-12. In reaching that decision, the Court stated that income is the "gain derived from capital, from labor, or from both combined." Id. at 201.

Taxpayer reads Merchant's Loan and Eisner together with certain other cases – Doyle v. Mitchell, 247 U.S. 179 (1918); Stratton's Independence v. Hobert, 231 U.S. 406 (1913) – as supporting his contention that the individual income can only be assessed against corporate gain. Taxpayer predicates this conclusion on selected case citations which, when taken together, purportedly limits the definition of "taxable income" to the definition originally established under the Civil War Income Tax Act of 1867. However, setting aside the question of the validity of taxpayer's legal analysis, taxpayer's conclusion concerning the definition of corporate income tax is ultimately irrelevant.

Taxpayer's legal analysis stands for nothing more than, when read in isolation and selectively divorced from the factual setting under which the decisions were reached, a legal argument can be proposed which will support any legal conclusion no matter how unjustified that conclusion is ultimately found. Taxpayer cites cases in which the Court was asked to determine what constituted *corporate income* under the corporate income and excise taxes in effect at the time the Court reached its conclusion. To apply Supreme

Court decisions limited to determining the efficacy and application of corporate income taxes to issues related to individual income tax may yield a desired result but is not legally, logically, or intellectually sound.

As set out in the Indiana Constitution, "The general assembly may levy and collect a tax upon income, from whatever source derived, at such rates, in such manner, and with such exemptions as may be prescribed by law." Ind. Const. art X, § 8. The Indiana General Assembly exercised its constitutional prerogative by imposing an adjusted gross income tax on individuals and corporations. IC 6-3-1-3.5 et seq. In doing so, the General Assembly defined an individual subject to the adjusted gross income tax as a "natural born person, whether married or unmarried, adult or minor." IC 6-3-1-9.

Although not binding upon the state's practice of taxing the wages of its own citizens, the United States Supreme Court has definitively ruled on the question of whether a citizen's individual income may be subjected to an adjusted gross income tax. In <u>New York v.</u> Graves, 300 U.S. 308, 312-13 (1937), Justice Stone stated as follows:

That the receipt of income by a resident of the territory of a taxing sovereignty is a taxable event is universally recognized. Domicil itself affords a basis for such taxation. Enjoyment of the privileges of residence in the state and the attendant right to invoke the protect of its laws are inseparable from the responsibility for sharing the costs of government A tax measured by the net income of residents is an equitable method of distributing the burdens of government among those who are privileged to enjoy its benefits. The tax, which is apportioned to the ability of the taxpayer to pay it, is founded upon the protection afforded by the state to the recipient of the income in his person, in his right to receive the income and in his enjoyment of it when received. These are rights and privileges which attach to domicil within the state. To them and to the equitable distribution of the tax burden, the economic advantage realized by the receipt of income and represented by the power to control it, bears a direct relationship. Neither the privilege nor the burden is affected by the character of the source from which the income is derived.

Since that 1937 decision, the federal courts have consistently, repeatedly, and without exception, determined that individual wages are income. <u>United States v. Connor</u>, 898 F2d 942. 943 (3rd Cir. 1990) ("Every court which has ever considered the issue has unequivocally rejected the argument that wages are not income"); <u>Wilcox v. Commissioner of Internal Revenue</u>, 848 F2d 1007, 1008 (9th Cir. 1988) ("First, wages are income."); <u>Coleman v. Commissioner of Internal Revenue</u>, 791 F2d 68, 70 (7th Cir. 1986) ("Wages are income, and the tax on wages is constitutional."); <u>United States v. Koliboski</u>, 732 F2d 1328, 1329 n. 1 (7th Cir. 1984) ("Let us now put [the question] to rest: WAGES ARE INCOME. Any reading of tax cases by would-be tax protesters now should preclude a claim of good-faith belief that wages – or salaries – are not taxable") (Emphasis in original); <u>United States v. Romero</u>, 640 F2d 1014, 1016 (9th Cir. 1981) ("Compensation for labor or services, paid in the form of wages or salary, has been universally held by the courts of this republic to be income, subject to the income tax

laws currently applicable. . . . [Taxpayer] seems to have been inspired by various tax protesting groups across the land who postulate weird and illogical theories of tax avoidance all to the detriment of the common weal [sic] and of themselves.").

In addressing the identical issue, the Indiana Tax Court has held that, "Common definition, an overwhelming body of case law by the United Sates Supreme Court and federal circuit courts, and this Court's opinion . . . all support the conclusion that wages are income for purposes of Indiana's adjusted gross income tax." Snyder v. Indiana Dept.of State Revenue, 723 N.E.2d 487, 491 (Ind. Tax Ct. 2000). State Revenue, 675 N.E.2d 362 (Ind. Tax Ct. 1997); Richey v. Indiana Dept.of State Revenue, 634 N.E.2d 1375 (Ind. Tax Ct. 1994).

Taxpayer has set out a more generalized argument in which he questions the disparity between the income tax as applied to corporations and as applied to individuals. According to taxpayer, a corporation is entitled to reduce its corporate tax liability by the amount of wages it pays to its employees. In contrast, a corporate employee who receives a wage is not entitled to reduce his own tax liability upon receipt of those very same wages.

The taxpayer is certainly entitled to point out the numerous exceptions, deductions, and eccentricities contained within the federal and state tax codes. It is beyond question that corporate taxpayers are entitled to numerous exemptions which may strike the taxpayer – rightly or wrongly – as inequitable. However, it is perhaps appropriate to point out that individual taxpayers are also entitled to exemptions and exclusions to which corporate taxpayers are not entitled. Other than the observation that state and federal tax policies are subject to the shifting sands of corporate, individual, government, and societal needs and influences, it is beyond the scope of this Letter of Findings to justify or rationalize every provision of the federal and Indiana tax codes. Nonetheless, it is equally obvious that taxpayer cannot justify a conclusion – based upon the distinction between corporate and individual income tax treatment – that taxpayer is unilaterally entitled to remove himself from the tax liabilities imposed on each and every citizen of the republic.

Despite taxpayer's assertions that he somehow stands outside the taxing authority of the state, given the taxpayer had taxable income, is an "individual" as defined by IC 6-3-1-0, was a resident of Indiana for the years at issue (IC 6-3-1-12), and is a "taxpayer" as defined within IC 6-3-1-15, the statutes imposing the Individual's income tax apply with full force to taxpayer's wages.

FINDING

Taxpayer's protest is denied.